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French Banking Federation Response to EBA Consultation Paper on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU (EBA/CP/2014/15)

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to comment the Consultation Paper on draft guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied.

- **Introductory Comments**

Whilst much of this Consultation Paper does not give rise to concern and reflects the undisputed need to identify impediments to resolution and to remove or mitigate their impacts, there are some aspects that give us concern.

1) The introduction of the concept of 'Loss absorbing capacity' is concerning. The Level 1 text of the Directive refers to MREL, any guidelines built upon this level 1 text should use the same concept. We would add that loss absorbing capacity is a concept that is still under discussion at international level, and that in any event its definition will not be the one given in the guidelines, which completely omit the notion of the capacity to recapitalise a failing institution.

2) In procedural terms, we are surprised that there is no mention of the process to be followed between resolution authorities and institutions following the identification of an impediment. There should be an exchange of views and potential solutions before any action is considered by resolution authorities. There should also be coordination with supervisory authorities, who may have differing views on the desirability of particular methods to mitigate impediments.

3) The notion of proportionality must be reinforced. Impediments to resolution must be true obstacles to a successful resolution, and not elements that may slightly complicate resolution. We would suggest that the introduction to paragraph 5 be amended to read

"Each of the measures listed in Article 17(5) of Directive 2014/59/EU may be applied only if they are suitable, necessary and proportionate, as evidenced by their meeting all of the three following conditions "

We provide more detailed comments in answer to each of the questions in the consultation below.

- **Detailed comments and answers to questions**

Question 1: Should there be further specification on variant strategies? Do you think the guidelines should differentiate between more or less important critical functions and provide for a fallback strategy to ensure the continuation of the most essential critical functions?

- Variant strategies:

We do not agree with the notion of variant strategies. There should be a preferred resolution strategy for a group that should be agreed by its Crisis Management Group (CMG). If this strategy does not achieve the objective of preserving financial stability by maintaining critical functions or cannot be expected to be successfully implemented, despite the removal of impediments, then this strategy would seem not to be suitable, and should be replaced by a viable strategy. There should be one overall resolution strategy for a group. It may have some degree of flexibility built in to adapt to different circumstances, but there should not be a variety of variant, and potentially conflicting strategies.

- Differentiation between "more or less important critical functions" :

We are surprised by the reference to 'more or less important', or 'essential' critical functions. Critical functions should be determined on a firm-by firm basis, and agreed by its CMG. At that point, a function is either considered critical or it is not, and therefore no differentiation should exist between more or less important critical functions. The same reasoning should apply to critical shared services.

In line with our comments on variant strategies above, we see no need for fall-back strategies for critical economic functions: the primary strategy should ensure their continuation.

Question 2: Do you see further cases for applying this measure? How can the asset structure of institutions be improved?

Point 8(a): Tightening of intra-group exposures & point 8(b) : Limiting exposure to non-consolidated entities:

We are concerned by these points concerning the tightening of intra-group exposures (toward consolidated or non consolidated entities).

The existence of intra-group exposures (in particular guarantees), rather than leading to contagion in a group, have the opposite effect of increasing its resilience by enabling it to support its subsidiaries. Restraining intra group exposures is likely to have a negative impact on a firm's resilience and its ability to withstand systemic crisis.

Measures to improve resolvability should not constitute intrusions into healthy financial firm's operational and legal structure. Freedom of organization should be safeguarded. In the particular case of intra-group funding by treasuries, these are often put in place to optimize the funding costs which does not prevent the capacity of subsidiaries to fund themselves in stressed times

- Point 9: Information requirements:

We agree that effective management information is essential to the management and supervision of an institution in both normal operations and in crisis management.

- Point 10: Requirement to divest assets prior to resolution and improvement of assets structures:

Great care should be taken that financial institutions' asset structure in a going-concern environment should not be modelled in order to address potential obstacles that would arise only in a resolution situation. In addition, it is difficult to find unquestionable criteria to assess which assets will pose significant issues in case of a remote and unpredictable resolution situation. Instead, authorities have the flexibility to choose the best appropriate resolution tool and in particular, the asset separation tool which ensures that in a given crisis context, problem assets can be isolated and liquidated smoothly.

The difficulty to evaluate an asset for resolution purposes should in no case be a reason for imposing the divestment of the said asset. Instead the evaluation method should be refined if needed until it is properly adapted to the asset.

If the asset structure makes certain resolution strategies inapplicable, then other resolution strategies should be chosen, rather than requiring an institution to divest assets in a going concern situation in order to address possible concerns in a hypothetical resolution situation. The only reason for which this would be acceptable is if an institution has an asset structure that makes resolution impossible.

Question 3: Do you see further cases for applying the measures considered in paragraphs 11 and 12? Are there specific types of activities or products that can constitute impediments for resolvability? How can these activities or products be identified in a targeted way?

The measures contained in paragraphs 11 and 12 are potentially extremely intrusive. We understand that they may be required in extreme circumstances, where an institution would prove impossible to resolve if these obstacles were not removed, and where there was no other means of resolving the impediment.

We would prefer that the paragraphs begin by 'Autorities should consider, in the absence of other mitigating factors……'

Question 4: Do you agree with the description of the potential advantages of a financial holding company structure? Do you see any disadvantages of this structure as regards financial stability?

The measures contained in paragraph 13 are, as for paragraphs 11 and 12, potentially highly intrusive, and should be qualified as suggested above. Particular attention should be paid to the following sub-paragraphs

- Point 13.(e): change structure from branches to subsidiaries: We do not agree that by permitting a bank to operate through a branch the host authority necessarily loses control either over the business or its assets and liabilities (see FED's distinction of branches between "aggregators" and "distributors"). We would refer the EBA to the IIF comment that "requiring a local branch of a bank to become a subsidiary significantly increases the risk of divergent approaches being applied by different resolution authorities to resolution. The advantages of ring-fencing assets for local creditors are matched by the loss of the recourse of those local creditors to other assets in other jurisdictions, and the degree of control that the regulator acquires over the local business by requiring subsidiarization is matched by the increased risk of divergent approaches to different parts of the same G-SIFI – an outcome that would almost certainly be detrimental to all creditors of that G-SIFI".

- Point 13.(g): ensure continued access to FMIs: in many instances it is impossible for an institution to obtain certainty of continued access to clearing, settlement and payment services. This may require regulatory action, and is not within the control of the institutions.

- Point 13.(j): this paragraph anticipates considerably on what may, or may not, prove to be a future international standard on loss absorbing capacity. The paragraph should limit itself to a description of MREL and its location within groups, in line with the Level 1 text.

- Point 13.(k): we are unsure as to the practical implications of this requirement. If it is a requirement for 'succession planning' , this already exists under supervisory

practice, but if it is more than that, it seems difficult to implement in practice, as it is not actually possible to prevent key staff from terminating their contractual relationship with the bank at any time.

Financial holding company structure: We would absolutely not agree that setting a holding company structure is the only way to achieve the benefit of bail-in. It is perfectly possible to achieve the same end through contractual means.

Moreover, such a model, whilst it may be the norm in other jurisdictions for historical reasons, is not that adopted by many European banking groups. In terms of financial stability, we believe that this is best served by allowing a variety of business models and structures to flourish in Europe.

Question 5: Do you agree with the description of loss absorption in groups? Should there be additional specification regarding how loss absorption is implemented?

We do not agree with the description of loss absorption within groups as outlined in 15 (b). MREL does not need to be calibrated to ensure loss absorption and recapitalisation across an entire group, as it is entirely feasible for a resolution strategy to envisage the maintenance of entities carrying out critical economic functions, and the liquidation of others. Therefore we propose to remove the word “entire”.

Loss absorbency, where it is required in order to preserve critical economic functions, does not necessarily need to be in the form of subordinated funding with no right of set-off, it can also be provided by mechanisms such as internal guarantees.

We would warn against the dangers of systematic pre-positioning of MREL throughout an SPE group, and this should certainly be refused within the Euro zone, which should be considered as a single ‘resolution entity’, with the same supervisor, same resolution regime, and a single resolution authority. Ring-fencing of MREL would reduce the group’s agility to face a crisis.